



## Attachment 3

*Michael C. Schlachter, CFA*  
*Managing Director*

December 1, 2008

Ms. Anne Stausboll  
Interim Chief Investment Officer  
California Public Employees' Retirement System  
400 P Street, Suite 3492  
Sacramento, CA 95814

Re: Currency Manager Contract Renewal Recommendation<sup>1</sup>

Dear Anne,

You requested Wilshire's opinion with respect to Staff's recommendation pertaining to the annual review and renewal of the contracts of the currency overlay managers. Wilshire concurs with Staff's recommendations, and our comments regarding both managers are below. Staff has the authority to terminate managers who do not perform as expected, and they have used that authority when necessary and appropriate. The renewal of these contracts does not in any way preclude Staff from exercising the authority to terminate any manager who ceases to perform as expected subsequent to contract renewal.

### **Recommendation**

**We recommend that the Investment Committee extend the contracts of both managers for another year.**

### **Discussion**

We agree with Staff's contention that this benchmark and the subsequent analysis of performance are asymmetrical, as the managers can only chose to be 100% fully hedged or less than 100% hedged, and have no incentive or mechanism to take a position greater than 100% hedged. As a result, when the dollar falls, any hedge ratio of less than 100% is virtually guaranteed to produce positive returns. Conversely, when the dollar strengthens, the best the managers can do is to fully hedge and generate no excess return. We have been working with Staff on ways to revise this program to allow for value-added in all markets and will continue to work to bring an agenda item regarding an

---

<sup>1</sup> Wilshire's Code of Conduct requires us to disclose which of the above firms are clients of Wilshire's Analytics Services Division and as such pay Wilshire a fee for the licensing of analytical software used in investment management. Wilshire's consulting division has no business relationship with them. This disclosure has been delivered under separate cover and is included as an attachment to this agenda item.

improved benchmark before the Investment Committee. In addition, Wilshire and Staff are currently working on improvements to the way CalPERS hedges all currencies across all investments.

### **Pareto Partners**

Since inception, Pareto has outperformed both the fully hedged and unhedged benchmarks, indicating that their process has added significant value for CalPERS. Over the past year, Pareto outperformed the fully hedged benchmark by 0.41% and the unhedged benchmark by 2.59%. Since inception, Pareto has added a total of 10.24% of excess cumulative return above the hedged benchmark and 4.25% excess return over the unhedged benchmark. Given the manager's long term outperformance versus both benchmarks, as well as the strong performance over the past year, we support Staff's recommendation to renew this manager's contract for another year.

### **State Street Global Advisors**

Although SSgA's performance lagged that of Pareto for the few years up to September 2005, the manager added more value than its counterpart in 2006 and 2007. For this past year, however, SSgA performed better than the unhedged benchmark (adding 0.90% of value) but trailed the hedged benchmark by 1.28%. Since inception, the manager has trailed the unhedged benchmark by 2.65% and the hedged benchmark by 1.10%. The manager has also failed to meet its self-imposed goal of capturing 60% of all upside returns over the last year.

Since inception in 1996, the manager trails both the hedged and unhedged benchmarks. However, over the last three years, the manager has generated positive returns relative to the unhedged alternative and has begun to improve the since-inception track record.

### **Conclusion**

Through the on-going activities of both CalPERS' consulting team and Wilshire's Manager Research Group, we closely monitor the performance and investment processes of all of CalPERS' managers. At this time, Wilshire concurs with Staff's recommendation to renew the contracts for both of the currency overlay managers, as CalPERS retains the right to terminate either with 30 days notice.

Sincerely,



Michael C. Schlachter, CFA